

CareFirst BlueCross BlueShield  
10455 Mill Run Circle  
Owings Mills, MD 21117

PRIVATE & CONFIDENTIAL

# Memo



To: Strategic Planning Committee  
Charles W. Shivery (Chairman)  
Daniel Altobello  
Edward J. Baran  
Max S. Bell, Jr., Esq.  
Sister Carol Keehan, R.N., M.S.  
Roger C. Lipitz  
Patricia E. Lund, Ed.D, R.N.  
Robert H. Naftaly

Finance Committee Attendees  
Robert F. Rider  
James C. Simpson

From: Dave Wolf *(signature)*

Subject: Background Materials for February 22<sup>nd</sup> Strategic Planning Committee Meeting

Date: February 16, 2001

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The attached materials are in preparation for our Strategic Planning Committee meeting, this Thursday, February 22<sup>nd</sup>, from 10:00 a.m. to 12:00 p.m. in the 9<sup>th</sup> floor Boardroom of CareFirst's Owings Mills offices. The Finance Committee has been invited, as well, to participate in the "Geographic Expansion" discussion.

We plan to review the following:

- ☐ Update on recent discussions with potential merger candidates, and other related activities;
- ☐ Overview of potential merger "finalists";
- ☐ Comparison of key transaction issues related to each candidate;
- ☐ Analysis of potential competitive reaction to a CareFirst merger announcement; and,
- ☐ Discussion of next steps.

Please let me know if you have any questions or concerns prior to the meeting (410-998-5553).

attachments

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## Strategic Planning Committee Meeting

### Contents:

Agenda & Minutes  
WellPoint Overview  
Trigon Overview  
Key Transaction Issues  
Interloper Analysis

OCC 016092

February 22, 2001  
10:00 a.m. - 12:00 p.m.

# Strategic Planning Committee Meeting

February 22, 2001, 10:00 a.m. to 12:00 p.m.

at

CareFirst, Inc. Owings Mills Offices  
9<sup>th</sup> Floor Boardroom

## Agenda

- |   |                            |                         |
|---|----------------------------|-------------------------|
| 1) Call to Order                                    | Shivery                    | 10:00 a.m. – 10:05 a.m. |
| <input type="checkbox"/> Review of 11/21/00 Minutes |                            |                         |
| <input type="checkbox"/> Review of 1/22/01 Minutes  |                            |                         |
| <input type="checkbox"/> Overview of Agenda         |                            |                         |
| 2) Analysis of Opportunities                        | Credit Suisse First Boston | 10:05 a.m. – 10:20 a.m. |
| 3) WellPoint & Trigon Corporate Overviews           | Wolf                       | 10:20 a.m. – 10:35 a.m. |
| 4) Key Transaction Issues                           | Credit Suisse First Boston | 10:35 a.m. – 11:05 a.m. |
| 5) Interloper Analysis                              | Credit Suisse First Boston | 11:05 a.m. – 11:40 a.m. |
| 6) Next Steps                                       | Credit Suisse First Boston | 11:40 a.m. – 11:50 a.m. |

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MINUTES OF THE COMBINED MEETING OF THE FINANCE COMMITTEE & STRATEGIC PLANNING COMMITTEE OF  
CAREFIRST, INC.

TUESDAY, NOVEMBER 21, 2000

AT ITS HEADQUARTERS IN OWINGS MILLS, MARYLAND

Members Present: Charles W. Shivery (Chairman); Daniel Altobello; Edward J. Baran; Max S. Bell, Jr., Esq.; Joseph Haskins; Sister Carol Keehan, R.N., M.S.; Roger C. Lipitz; Patricia E. Lund, Ed.D., R.N.; Robert H. Naftaly (Chairman); Robert F. Rider; James C. Simpson

Also Present: William L. Jews; Mark Chaney; Gregory A. Devou; Paul King; John A. Picciotto; Tom Rekart; Sharon Vecchioni; David D. Wolf; Sandy Beard; Benjamin Adams; Elizabeth Grieb; Patrick McMullan; Stuart Smith

The meeting was called to order by Chairmans Shivery and Naftaly

Staff and advisor presentations were made through the use of a handout which had previously been distributed to the Committee, and which is made a part of these minutes.

The minutes of the October 26, 2000 Strategic Planning Committee and the minutes of the October 26, 2000 Finance Committee were approved as submitted.

Mr. Chaney reviewed CareFirst's financial performance through October 2000. He reported that CareFirst, Inc., including BCBSD, had a \$17 million unfavorable variance to Planned Net Income of \$69 million. He attributed the variance to unanticipated losses in the public sector programs as well as in CareFirst of Maryland's commercial HMO. He noted that the year 2000 losses would be partially offset by CareFirst's anticipated exit from the Medicaid program. He also noted that a plan has been proposed, to take effect in 2001 if approved by all the necessary parties, that should address future losses in the FreeState HMO.

Mr. Chaney provided further detail regarding the financial performance of each of the entities comprising CareFirst, Inc. He reported that CareFirst of Maryland (CFMI) has generated Net Income of \$4 million, October year-to-date. However, this gain is \$30 million unfavorable to Plan. Again, this performance was attributed to losses in the public sector programs.

Mr. Chaney then reported that Group Hospitalization and Medical Services (GHMSI) had a \$23 million favorable variance to Planned Net Income. The variance was attributed to lower-than-expected Operating Expenses.

Mr. Chaney also reviewed BlueCross BlueShield of Delaware's financial performance, noting that Net Income from Operations was essentially "on track" compared to Plan, with a \$1 million gain, year-to-date. He shared that the plan was beginning to recognize some synergies from the CareFirst affiliation, and that the plan was managing administrative expenses well.

Mr. Chaney's review of CareFirst, Inc.'s Statutory results reflected a 3.9% growth in net worth, year-to-date; and Mr. Chaney confirmed that CareFirst remains well able to meet all reserve and risk-based capital requirements. He then closed with the 2000 Forecast, projecting that Net Income from Operations will be approximately \$10 million negative to Plan, at approximately \$76.8 million.

A discussion of the 2001 Plan followed. Mr. Chaney projected 10 percent Revenue growth, and 20 percent Net Income growth, which translates into \$59 million in Underwriting Gain (1 percent margin), and \$92 million in Net Income (1.6% margin). He expects CareFirst to maintain or improve its current A- Standard and Poor's rating, especially given profit margins that compare favorably to the industry, overall. At one percent, Mr. Chaney projected

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enrollment growth to be slower than what has been achieved historically: commercial growth will have to accelerate to fill the resultant gap from the public sector exit. However, this strategic exit should enhance Medical Loss Ratios, with 2001 falling to 89.9 percent from 90.5 percent in 2000. Investment in e-commerce and mandates will push up Administrative Ratios slightly, from 8.9 percent to 9.1 percent.

Corrective action to address FreeState losses is not expected to positively affect CareFirst financial performance until 2002 due to run-out periods and regulatory requirements associated with the planned HMO restructuring. Mr. Shivery inquired about Mr. Chaney's confidence level that the 2001 targets could be achieved. Mr. Chaney responded that he has about a 65 percent confidence level, noting that even minor swings in care costs and uncertainty associated with rate approvals can radically change financial outcomes. He also noted that planned adjustments to broker commissioning methodology should assist CareFirst in achieving its 2001 financial goals.

Mr. Devou then reviewed CareFirst's plan to maximize net margin in 2001 through four key strategies: profitable market share growth, management of medical and administrative costs, exiting unmanageable segments, and enhancing CareFirst's image. He projected enrollment to reach 1.7 million contracts, reflective of nearly 7 percent growth. Mr. Devou continued, describing CareFirst's "Managed Care Repositioning" initiative, key to achieving HMO profitability. The project will create a single, consolidated CareFirst fee-for-service managed care portfolio. He closed with a description of CareFirst's new distribution and image-enhancement strategies.

Mr. Rekart provided an overview of CareFirst's information technology. Key projects include e-commerce, HIPAA compliance, information management and the data warehouse. He noted that CareFirst has been recognized as having an award-winning web site, with further enhancements planned for 2001. Mr. Rekart also reviewed CareFirst's plan to integrate "core systems", migrating from seven distinct platforms to three consolidated systems.

Mr. Wolf concluded the presentation of CareFirst's 2001 Plan with an overview of the Medical Management plan for 2001. Key initiatives include implementation of a new network strategy, inclusive of Alternative Rating Arrangements and regional networks, an owned medical group strategy, expansion of care and disease management programs, and implementation of a Research Institute. He noted that these strategies must continue to address the ongoing "managed care backlash" aimed at the industry.

Mr. Altobello made a motion to approve the plan for presentation to the Board, with a second from Sister Keehan. The Committee approved the motion.

Mr. McMullan, from Credit Suisse First Boston (CSFB) then provided an update on CareFirst's geographic expansion initiatives. He noted that while an open dialogue continues with multiple plans, CareFirst is preparing a data room for preliminary due diligence by the Trigon team. CSFB's goal is to have a list of key criteria that would be considered in negotiating a transaction to be presented at the annual Board retreat. Mr. McMullan explained that this will be a dynamic process, contingent upon the speed with which the potential partners elect to proceed.

There being no further business, the meeting adjourned at 12:03 p.m.

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David D. Wolf  
EVP, Medical Systems and  
Corporate Development

MINUTES OF THE MEETING OF THE STRATEGIC PLANNING COMMITTEE OF CAREFIRST, INC.  
MONDAY, JANUARY 22, 2001  
AT ITS HEADQUARTERS IN OWINGS MILLS, MARYLAND

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Members Present: Charles W. Shivery (Chairman); Daniel Altobello; Edward J. Baran; Max S. Bell, Jr., Esq.; Joseph Haskins; Sister Carol Keehan, R.N., M.S.; Roger C. Lipitz; Patricia E. Lund, Ed.D., R.N.; Robert H. Naftaly

Also Present: William L. Jews; Mark Chaney; Gregory A. Devou; Leon Kaplan; Paul King; John A. Picciotto; Sharon Vecchioni; David D. Wolf; Sandy Beard; Benjamin Adams; Elizabeth Grieb; Larry Levine; Patrick McMullan; Michael Muntner; Grace Yun

The meeting was called to order by Chairman Shivery.

Staff and advisor presentations were made through the use of a handout which had previously been distributed to the Committee, and which is made a part of these minutes.

Ms. Grieb, CareFirst's outside legal counsel (Piper, Marbury, Rudnick & Wolfe), reviewed the Board of Directors' responsibilities, related to a potential transaction. She noted that while there would be minor differences, the duties are substantially the same across jurisdictions. Ms. Grieb also noted that unlike a public company sale, the proposed transaction does not subject the CareFirst Directors to a duty to maximize price. Rather, the Directors must obtain a fair price, but can also consider other non-price factors. Among the factors to be considered, Ms. Grieb cited several, including continued local presence, on-going continuation of subscribers' coverage, overall constituent benefits, as well as foundation funding. The Board's accountability will be to assess the comprehensive offer, as opposed to focusing on a single component.

Mr. Jews followed with an update of recent activities, noting that the investment bankers had re-confirmed CareFirst's strategic direction early in 2000, and had subsequently narrowed the list of potential candidates to four. Further development of a business case narrowed the field to Trigon and WellPoint, two plans that the Board acknowledged as being the most viable partners during December's Year 2000 Annual Board Meeting. Mr. Jews reported that during the past month, multiple conversations and meetings between himself and the principals have occurred, and that preliminary outlines of an agreement have been developed with both Trigon and WellPoint. He noted that the next steps are CareFirst due diligence of both plans: the due diligence process will evaluate multiple criteria, among which total economic value and "do-ability" are key. Findings will be presented to the Committee and the Board of Directors.

Mr. McMullan, representing Credit Suisse, First Boston (CSFB), reviewed multiple criteria for assessing the plans. The criteria include economic benefit, "do-ability", governance, long-term strategy and goals, and the overall business case. Mr. Lipitz requested an analysis of key constituent's perceptions, not just the parties to the transaction. Mr. McMullan agreed to this assessment, as well an analysis of the impact of CareFirst forgoing any type of further strategic expansion or partnership.

Mr. Picciotto reviewed the "do-ability" of both transactions from a regulatory perspective, focusing on decision-makers and influencers by jurisdiction. Mr. Lipitz stressed the need for a comprehensive communication plan, both pre- and post-announcement, to key individuals who could affect the outcome of the transaction. Mr. Shivery inquired whether one partner is more likely than the other to result in a successful transaction. Mr. Jews responded that both plans continue to discuss expansion opportunities with us in good faith, and that there are no "fatal flaws" apparent in either

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candidate. Selection of a final candidate will depend on the terms offered, as well as information gathered during the due diligence process.

Mr. Jews reviewed the process and timeline, noting that the goal of CareFirst's due diligence is face-to-face assessment and inquiry of the partners. Mr. Haskins asked the group to consider the partners' image with external parties, including employers, providers, policyholders, regulators, and others. Mr. Naftaly advised the group to anticipate any other strategic transactions the partners might be considering and impact it would have on CareFirst's long term goals. The group anticipated reviewing preliminary due diligence findings at the February SPC and Board meetings. However, Mr. Altobello noted that additional, unscheduled meetings will be necessary to obtain full Board approval to proceed. In the meantime, Mr. Altobello requested that CSFB calculate the "fair market value" of CareFirst, in the context of today's fluctuating market.

There being no further business, the meeting adjourned at 9:30 a.m.

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David D. Wolf  
EVP, Medical Systems and  
Corporate Development